

This record is a partial extract of the original cable. The full text of the original cable is not available.

C O N F I D E N T I A L SECTION 01 OF 02 ANKARA 008255

SIPDIS

SENSITIVE

STATE FOR E, EB, AND EUR/SE
TREASURY FOR OASIA - MILLS AND GUNARATNE
USDOC FOR 4212/ITA/MAC/OEURA/CDP/DDEFALCO
STATE PASS USTR - NOVELLI AND BIRDSEY

E.O. 12958: DECL: 09/02/2006

TAGS: [EINV](#) [EFIN](#) [TU](#)

SUBJECT: CITIBANK CLIENTS GET SLAPPED WITH \$1.5 BILLION
TURKISH CLAIM FOR BACK TAXES: POTENTIAL GIANT INVESTMENT
DISPUTE

Classified by the Ambassador for reason 1.5 (b).

1. (C) SUMMARY: Citibank's foreign investor clients in Turkey were recently disallowed long-standing preferential tax treatment on T-bill income. These investors' T-bill income from 1997 to present was reassessed at a 44 percent tax rate, rather than the preferential 11 percent tax rate, resulting in a whopping tax claim of \$1.5 billion submitted to Citibank as these investors' custodian in Turkey. Citibank is quietly working with GOT bureaucrats now, but is concerned that this issue not surface in the local media. The Ambassador told Citibank execs in Ankara that we will coordinate a high-level approach, starting with the new Finance Minister, as soon as the new GOT is in place. END SUMMARY.

2. (C) Citigroup's London-based Director of Global Securities for Europe, Japan and MidEast Jim Donovan, and Citibank GM for Turkey Mark Robinson briefed the Ambassador on a serious new issue with the Government of Turkey. Last month a Turkish tax inspector disallowed - only for Citibank and its clients - the long-standing preferential tax treatment of T-bill income of non-Turkish residents. The result is a claim for back taxes, with penalties and interest, of \$1.5 billion. The tax inspectorate requested that Citibank deposit \$500 million in collateral in advance of resolving this claim. Donovan told the Ambassador that the collateral deposit has been dropped, but the tax assessment is outstanding, and Citibank is treating it very seriously.

3. (C) Citibank, JP Morgan/Chase and several Turkish banks (including Garanti Bankasi) have foreign clients who invest in the local T-bill market, through custodial accounts kept in the banks. In Turkish legal parlance, the bank is the "permanent representative" for these investments. Investments by corporations formed outside of Turkey, which have no Turkish residence, and which bring funds into Turkey have long benefited from preferential tax treatment. This treatment is spelled out in a Capital Markets Board circular. It states that foreign investment in the local T-bill market is taxed at the rate of 11 percent (versus the 44 percent rate at which Turkish residents are taxed on T-bill income). If 25 percent or more of the foreign investment is put in the Turkish equities market, then the tax rate on income from the whole investment is zero.

4. (C) According to the Citibank execs, the Finance Ministry's tax inspector recently disallowed the preferential tax treatment for Citibank and its clients, and applied the 44 percent tax rate retroactively for the period 1997-2000. Per Citibank, this is the action of one tax inspector, and this kind of assessment has not been applied to other banks with foreign investor clients.

5. (C) Citibank execs Donovan and Robinson met November 14 with the Finance Ministry's DG for revenue Mete Sahin, Treasury U/S Faik Oztrak and others in Ankara. They told the Ambassador that these bureaucrats were supportive of Citibank's position - that this retroactive change in tax treatment is unfair to foreign investors, and Citibank will not agree to submit this claim to a settlement commission. But the bureaucrats also noted the need to get the incoming government's approval before making any decisions on this case. Citibank will wait for the new GOT to be formed before raising this issue with the new Finance Ministry.

6. (C) At present, Citibank is not asking the USG to intervene with the GOT, per Donovan and Robinson. They have

hired local accountants Price Waterhouse and Ernest and Young, and local attorneys, to begin talking with AK Party figures. They will stay in touch with us, and coordinate approaches at the ministerial level, very soon after the new GOT is formed. Citibank is concerned that, if this issue leaks into the local press, then the chances of quietly resolving the claim are much less. The Ambassador agreed with this approach, and expressed his willingness to raise this with the new GOT once it is formed.

17. (C) Comment: Citibank has been in Turkey for 25 years. While maintaining a small commercial banking presence, it has trained a whole generation of Turkish banking executives (including BRSA Chairman Akcakoca, former State Bank Board Chairman Akisik, Kocbank CEO Karacaham and others). Furthermore, its investor clients (including Goldman Sachs, Merrill Lynch) have at times been major players in the local T-bill market. Press criticism of "foreign banks" surfaces from time to time and calls them a bunch of speculators. This outrageous tax assessment raises new risks to all foreign portfolio investors. We will work with Citibank to nip it in the bud with the AK government.

PEARSON